COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Petition of the Cape Light Compact)

and Various Member Towns Regarding)

the Purchase of Street Lighting Equipment) D.T.E. 01-25

from Commonwealth Electric Company)

)

BRIEF OF THE PETITIONERS CAPE LIGHT COMPACT AND NINETEEN MEMBER TOWNS

In 1997, as part of a larger effort to unbundle and deregulate the electric industry, the Legislature gave municipalities the right to purchase street lights, upon paying utilities for their "unamortized investment." This case calls upon DTE to choose between two methods for ascertaining this "unamortized investment," one proposed by the Cape Light Compact ("the Compact"), the second proposed by Commonwealth Electric Company ("the Company"). The Compact's method charges municipalities for that portion of the Company's investment that the Company has not recovered from ratepayers as a return on its rate base. The Compact's method: 1) complies with the plain language of the governing statute; 2) treats municipalities and the Company fairly; 3) uses DTE-approved rates of depreciation; and 4) is easy and transparent to administer.

In stark contrast, the Company's method would charge each municipality for street lights that the municipality has already fully paid for, in some cases two or three times over. To make matters even more unfair, the Company would have the municipality compensate the Company for prematurely retired street lights that do not even exist, and may never have existed in the purchasing municipality. The Company's method is therefore patently unfair. It also: 1) violates the express terms of the statute; 2) uses depreciation rates and methodologies that have never been approved by the Department or used for any other purpose but this one; and 3) is complex and opaque. The Company's method fails to meet any criteria, except one -- it extracts more money from municipalities that wish to exercise a statutory right.

PROCEDURAL HISTORY

The Compact is an inter-governmental consortium founded for various purposes, including the operation of municipal aggregation and energy efficiency programs. G.L. c. 164, §34; In re Cape Light Compact, DTE 00-47. The Compact also analyzes options to reduce its members energy bills, including purchasing street lights under G.L. c. 164, §34A.(1)

Three Compact members, Harwich, Sandwich and Edgartown, have tried to buy their lights from the Company. "Petition of the Cape Light Compact and Nineteen Member Towns Regarding the Purchase of Street Lights from Commonwealth Electric Company" ("Petition"), ¶4. The Company provided two proposals to each of these towns for the street light purchase. The Towns rejected the first offer made in February 2000 because it was unfair and excessively high. The Company responded with a second

proposal of December 2000 that was two to three times higher than the February proposal. Petition, ¶¶4-7.

Rather than pay the excessive price that the Company demanded, on January 26, 2001, the Compact filed a Petition with this Department. The Petition demonstrates that there is a dispute between the Compact and the Company as to the proper method to calculate the purchase price. Petition, ¶¶4-7. The Petition requests that this Department specifically adjudicate the prices that Harwich, Edgartown and Sandwich should pay, and rule that the methodology proposed by the Compact is the correct method and should be applied to any of the remaining Compact towns should they seek to purchase their street lights. The Department has jurisdiction to resolve this dispute under G.L. c. 164, ¶34A(d), which provides in pertinent part that "any dispute concerning ... the compensation to be paid the electric company ... shall be resolved by the Department within sixty days of any request for such resolution by the municipality or any other person involved in such dispute."

OVERVIEW OF COMPACT METHOD AND COMPANY METHOD
G.L. c. 164, §34A (b) governs this case. The statutes provides as follows:

Any municipality exercising the option to convert its street lighting service pursuant to subsection (a) shall be required to compensate the electric company for its unamortized investment, net of any salvage value obtained by the electric company under the circumstances, in the lighting equipment owned by the electric company in the municipality as of the date the electric company receives notice of such exercise pursuant to subsection (a).

Compact Method
The Compact defined the key term "unamortized investment" as "the part of the original investment that had [not] been written off using the depreciation rates approved by the Department." April 25, 2001 Transcript ("Tr.") 37; Direct Testimony of Paul Chernick (Exhibit Compact 1), p. 3. The Compact calculated the unamortized investment in the following manner. First, the Compact obtained from the Company the original cost and year of installation for each streetlight in each of the three towns, and the percentage of lights that are town lights and private lights. Exhibit Compact 1, p. 9; PLC-5 . The Compact then depreciated each vintage group of town lights using an annual 7.14% depreciation rate, which it believed was the rate approved by the DTE (then DPU). Id. The Compact assigned positive values to lights which were younger than fourteen years, and negative values to lights which were older than fourteen years and which were therefore fully depreciated. Id. The Compact then added the positive values to the negative ones, and arrived at a net value for each town. Id.

The Compact then made an important correction to its calculation. After receiving discovery responses from the Company, the Compact learned that the 7.14% rate was not the DTE-approved depreciation rate, and that the Company was actually using several different rates, all of which are higher than the 7.14% rate. Thus, the Compact modified its calculations by using the actual depreciation rates approved by the Department, rather than the 7.14% rate initially provided by the Company. Tr. 17; see also Exhibit Compact 1A (revised table with new depreciation rates); Exhibit CLC 1-1 (list of Department-approved depreciation rates). After making this revision, the Compact ascertained that the purchase price for each town was zero. This is because for each town, the mix of lights is such that the negative sum of the older, over-depreciated lights exceeds the positive sum of the newer, under-depreciated lights. In other words, the Towns have fully paid for the entire group of street lights that each seeks to purchase. Tr. 21; Exhibit Compact 1A.

The Company assessed the purchase price in a very different method. Under its "December" method(2), the Company "allocate[s] the systemwide net balance as it exists on the books of the company to each town, rather than compute[s] the unamortized cost of the plant in the town." Tr. 23. The allocation is not based on

original cost minus collected amortization, but rather is based upon the estimated useful life remaining life of the equipment. Tr. 23-4. And, this method is intended not only to allow the Company to recover for street lights that exist in the Town as of the date of purchase, but to recover for lights that have been retired anywhere on the Company's system at any time in the past. Tr. 24; Robinson Testimony, Exhibit BKR-1, p. 5.

In order to perform this systemwide allocation, the Company first derives a "theoretical" reserve, which appears to be a "target" reserve based on mortality curves that it has applied to street lights. Exhibit CLC 1-6; Exhibit Compact 5; Tr. 26-28. The Company then compares the theoretical reserve to the actual reserve. If the actual reserve is lower, the Company adjusts the theoretical reserve depreciation rates for each vintage, so that the theoretical reserve equals the actual reserve on a systemwide basis. Tr. 29; Exhibit CLC 1-6, p. 2, section II(C)(formula when actual reserve is less than theoretical reserve). Then, the Company applies this systemwide adjustment factor to the lights in the three towns. Tr. 30; Exhibit CLC 1-6. Using Exhibit Compact 5 as an illustrative example (with a simplified 8% depreciation rate), 25 year old lights would be 55% depreciated, rather than, as the Compact's method, over 100% depreciated.

THE COMPACT'S METHOD IS CONSISTENT WITH THE PLAIN LANGUAGE OF THE STATUTE; THE COMPANY'S METHOD OFFENDS THE STATUTE IN TWO DISTINCT RESPECTS

The Compact's Method Complies with the Term "Unamortized Investment", while the Company's Method Uses a Different Concept of Physical Depreciation

The Legislature required municipalities to compensate electric companies for the "unamortized investment" in the street lights. G.L. c. 164, §34A(b). The term "unamortized investment" is not specifically defined in the statute, but it typically means "[t]he allocation (and charge to expense) of the cost or other basis of an intangible asset over its estimated useful life." Black's Law Dictionary, 5th Ed. p. 76, Exhibit Compact 3. In the utility ratemaking context, amortization represents "the amortized costs of the assets in the sense of that part of the costs which has already been charged, or which should have been charged, to previous periods of operation....what is deducted as depreciation is the cost that has been, or should have been amortized and not the actual decline in value, estimated with the benefit of hindsight." Bonbright et al, Principles of Public Utility Rates, p. 270, Exhibit Compact 4. Thus, "unamortized investment" means, quite simply, the portion of an investment which has not yet been charged to ratepayers under depreciation rates approved in ratemaking proceedings.

That is precisely what the Compact's method would allow the Company to collect. The Compact takes the original cost of all street lights that exist in each town, and subtracts from that original cost that portion of the cost that has already been charged to previous periods of operation. Lights that are not fully depreciated have a positive value; lights that are fully depreciated have a negative value, reflecting the fact that ratepayers have already paid for those lights. The Compact adds the "positive" and "negative" values together, because what the municipalities purchase is the total street light plant, and the "unamortized investment" in the total plant is that portion of the investment for which the Company has not already been compensated.(3)

The Company defines and calculates "unamortized investment" in a radically different manner. The Company seems to define "unamortized investment" as "the investment net of physical depreciation." Tr. 41-2. Thus, the Company seeks to calculate not the portion of the street light costs that have been amortized, but the remaining useful life of the street lights based on mortality curves. Tr. 41. But this is not the meaning of "unamortized investment." Indeed, both Black's Law Dictionary and

Bonbright counsel against this misinterpretation. As Black's Law Dictionary makes clear, amortization is "distinguished from depreciation, which is an allocation of the original cost of an asset computed from physical wear and tear as well as the passage of time." Moreover, in utility ratemaking, the term depreciation does not mean physical wear and tear, but rather that portion of the cost of the asset that has not been charged to ratepayers. Bonbright, p. 270, Exhibit Compact 4. (4)

When the legislature uses a technical term such as "unamortized investment," it should be interpreted in accordance with its technical meaning. G.L. c. 4, §6 ("technical words and phrases and such others as may have acquired a peculiar and appropriate meaning in law shall be construed and understood according to such meaning"). Had the Legislature intended for the street light purchase price to reflect concepts such as physical wear and tear or obsolescence, it could have used terms such as "fair market value" or "remaining useful life." Thus, the Department should interpret the term "unamortized investment" in accordance with its technical meaning, as the Compact has done, and not stretch the statutory language to encompass concepts that are outside of this meaning, as the Company has done.

The Compact's Method, but Not the Company's Method, Values Lights Existing in the Purchasing Municipality Only

The statute calls for a valuation of only "the lighting equipment owned by the electric company in the municipality as of the date the electric company receives notice." G.L. c. 164, §34A(b) (italics added). The Compact's method clearly complies with this mandate, because the Compact places a monetary value only upon those lights that actually exist in the municipality as of the notice date. Tr. 43.

In contrast, the Company's method violates this simple statutory language in three ways. First, it purports to increase the price that Towns would otherwise pay to compensate the Company for lights in that town that were allegedly retired before the notice date. Robinson Testimony, Exhibit BKR-1, p. 5; Tr. 32-33. Second, the Company's method in effect increases the purchase price to compensate for early retirements anywhere in the Company's system. Tr. 34. Third, the Company's allocation method makes the price that one town pays dependent in part upon investments in other towns. Exhibit Compact 1, p. 8. For example, if the Company modernizes street lights in New Bedford, this affects the "theoretical reserve" which is allocated in part to the purchasing towns. Id., p. 8; Exhibit CLC 1-6 (Depreciation Reserve Allocation Methodology, p. 2); Tr. 45-46. The Company's witness, Michael Farrell, conceded this point.

Tr. 157.

Thus, the Company's method directly conflicts with the literal meaning of the statutory term "lighting equipment ...in the municipality as of the [notice] date." The Company's method is not a valuation of the specific lights within the purchasing municipality, but rather a theoretical allocation of systemwide costs to a purchasing municipality, designed to require municipalities to compensate the Company for investments that it has made outside of the town's borders. The Department should reject the Company's attempt to impose cost well beyond those specified in the words of the statute.

THE COMPACT'S METHOD IS FAIR TO THE TOWNS AND COMPANY; THE COMPANY'S METHOD EXTRACTS AN UNFAIR PENALTY FROM THE MUNICIPALITIES

The Compact's method not only tracks the statutory language, it is fair. The Compact's method requires a purchasing town to pay the Company for that portion of its investment for which it has not already been compensated. Under the Compact's method, a town does not pay twice, first as a ratepayer and then as a purchaser. In

contrast, the Company's method makes a town pay twice, and sometimes three or four times over, for the lights it is purchasing.

The Company admits that ratepayers continue to pay for lights that remain in service well after their estimated average life. Tr. 123, 140; Exhibit Compact 1, p. 5. Assuming for this example a fourteen year average life and a 7.14% depreciation rate, this means that the Company collects from ratepayers two times its original investment for a light that is 28 years old, and three times its original investment for a light that is 42 years old. Yet, under the Company's method, when a municipality seeks to buy 28 or 42 year old lights, it must still pay the Company for those lights. Indeed, under the Company's method a light never has negative value, no matter how many times over the ratepayers have paid for it. Tr. 89; Exhibit DTE 1-2C; Exhibit Compact 1, p. 8 and PLC-4 (Company shows positive value for light that is 52 years old).

It is simply unfair to make municipalities pay for street lights that the ratepayers have already paid for, sometimes two or three times over. This gives the Company a windfall, and penalizes the municipalities for exercising a statutory right.

The Company advances only one argument to justify this unfairness. The Company claims that it should be compensated for lights that are retired prior to their full depreciation, and it cannot do so under the Compact's method. Exhibit BKR-1, p. 5; Exhibit CLC1-5. There is no merit to this argument.

First, there is not a shred of evidence that in Harwich, Edgartown, or Sandwich, lights have been taken out of service before the expiration of their useful life, or that the Company is under-compensated due to this phenomenon. Exhibit CLC 2-29. Indeed, the Company readily admits that it does not maintain data by town on early retirements, so it has no idea whether there is any under-compensation with respect to these three towns. Exhibit CLC 2-29. Indeed, it is just as possible that in these three towns, there have been so few early retirements that the sum of the over-depreciated, existing lights vastly exceeds the sum of any under-depreciated, early-retired lights. Thus, it is unfair to make these three towns pay for early retirements that the Company cannot even show occurred in these towns.

Given the absence of any evidence linking the Company's alleged "under-compensation" to these three towns, the only fair way of compensating the Company (if the Company really sustains a loss) is through a systemwide charge. Indeed, the Department has consistently adhered to the principle that general costs which are not linked to any particular class of customers should be allocated over the entire customer base. For example, in Western Massachusetts Electric Company, DPU 90-300, the Department ruled as follows with respect to the allocation of general overhead expenses:

Since general overhead expenses are not dedicated to serve any particular customer group directly, but are dedicated to serve the Company's customers as a whole it makes little sense to attempt to establish a direct cause/effect link between cost incurrence and the expenses or consumption patterns associated with any individual customer class. In this situation, it is more important to develop a fair sharing of these costs between customer groups. Therefore, it is appropriate to allocate general overhead expenses to customer classes based proportionally on class revenue requirements rather than to rely on a narrow allocator such as plant or payroll.

Similarly, when utilities are required to incur "social costs" that cannot be attributed to any particular class of ratepayers, such costs are typically spread amongst all ratepayers. Western Mass. Electric, DPU 88-250 (1989), p. 130 (low-income subsidy cost should be borne by all ratepayers, and not allocated to residential classes because residential classes are not specifically responsible for this cost). There is no reason to treat the alleged systemwide "cost" of early retirements any differently.

Indeed, if the Company sustains any loss due to this "unbundling" of its street light service, this loss is analogous to other stranded costs which arose because of restructuring. Tr. 36-7. Just as these other stranded costs have been borne by all ratepayers in the form of a transition charge, so too should this cost (if there is one).

THE COMPACT'S METHOD IS CONSISTENT WITH THE COMPANY'S OWN METHODS FOR VALUING THESE ASSETS; THE COMPANY'S METHOD WAS CREATED FOR THE SINGLE PURPOSE OF INFLATING THE STREET LIGHT PURCHASE PRICE

Once can safely presume that when the Legislature enacted the G.L. c. 164, § 34A, it intended for lights to be valued in accordance with pre-existing formulas and methodologies. In particular, the Legislature certainly knew that street lights are a depreciable asset, and that depreciation is accounted for in ratemaking proceedings. Thus, any system for ascertaining the "unamortized investment" in the street lights should tie into and be consistent with amortization methods approved by this Department.

The Compact's method meets this standard. The Compact calculates unamortized investment by using the specific depreciation rates that this Department approved in the Company's rate proceedings. Tr. 22, Exhibit CLC 1-1 (table of Company's approved depreciation rates used by the Compact to prepare Exhibit Compact 1A and 1B). These depreciation rates have stood the test of time, and the Company has been allowed to charge rates to earn a fair return on its street light investment in addition to recovery of these depreciation rates.

In stark contrast, the Company uses a series of depreciation rates and allocation methodologies that have never been approved by this Department. These formulas have not been used for setting rates. Exhibit CLC 2-1. They have not been used for accounting purposes. Exhibit CLC 2-3. They have not been used for property tax valuation. Exhibit CLC 1-8. In fact, the Company first started using these formulas in April 2000. Exhibit CLC 2-24. The Company admits that it created these formulas because it was dissatisfied with the amount of money it would extract from municipalities using DTE approved depreciation rates. Robinson Testimony, p. 4, Exhibit BKR-1. In other words, the Company proposed rates for depreciating street lights in a series of rate cases from 1976 to the present, but now wants to change those rates to earn an even higher return on its original investment. This should not be allowed.

The Compact's method is also consistent with the one prior case decided by the Department, Petition of Acton and Lexington, DTE 98-89. The Compact's method uses approved depreciation rates to amortize the costs, continues amortization at these approved rates as long as the plant is in service so that some lights have negative value, and does not base the valuation on additions or retirements in other towns. Exhibit DTE-1-IT. The Acton/Lexington method shares these features. Id.

In contrast, the Company's method uses depreciation rates that have not been approved, applies rates that prevent any light from having a negative value, and bases the valuation in part upon additions or retirements in other towns. Exhibit Compact 1, pp. 7-8. Thus, as the Company admits, its method is inconsistent with the method this Department approved in DTE 98-89. Robinson Testimony, pps. 4-5, Exhibit BKR-1.

THE COMPACT'S METHOD IS EASY TO APPLY AND BASED ON PUBLICLY AVAILABLE DATA; THE COMPANY'S METHOD IS COMPLEX, OPAQUE, AND BASED ON INTERNAL DATA

One can also safely presume that when the Legislature enacted G.L. c. 164, §34A, it wanted the street light purchase process to be as simple and expeditious as possible. Indeed, it established a two month deadline for this Department to adjudicate disputes arising under this statute. The Compact's method is simple and expeditious, as it merely requires one to know 1) the age of street lights in the particular town; 2) the original cost of those lights; and 3) the rates of depreciation. Tr. 44. And if one needed to adjust an initial calculation because of the passage of time, all one would need do is subtract additional amortization. Tr. 44.

In stark contrast, the Company's method is complex and incomprehensible to anyone except a professional trained in the subject matter, and possessing frequently-updated financial information for the Company's entire system of streetlights. All the Department need do is peruse the attachment to Exhibit CLC 1-6 and its three pages of mathematical formulas and Greek insignias to see the Rube Goldberg-like nature of the Company's construct. Moreover, in order to merely update a calculation for a particular town using the Company's method, one would have to perform the following steps:

1. Determine the original cost by vintage of the entire street light system;

2. Adjust the original cost for any retirements or additions anywhere in the system;

3. Determine the system accumulated reserve;

4. Run the computer model to generate a stream of theoretical factors by vintage;

5. Compute the systemwide theoretical reserve;

6. Derive the appropriate adjustment factors;

7. Apply those factors to the specific municipality in question.

Tr. 46-47. Not only is this method extremely complex, but many of the steps are not based on readily available data, but upon internal formulas contained in the Power Plan computer program. Tr. 46-7.

This Department has long recognized the value of using simple formulas and publicly available data to resolve disputes such as this one. For example, the Department concluded that for the purpose of determining "pole attachment" rates for cable companies, "reliance on publicly available utility annual report data is preferable to rate formulas dependent upon internal utility information..." Greater Media, DPU 91-128 (1992), p. 14. The Department later noted that "as a result of this reliance upon utility annual reports as a basis for attachment rate calculations, the Department was not only able to establish reasonable conduit attachment rates, but also to put into place a mechanism by which conduit attachment rates could be adjusted annually thereafter without the need for costly adjudications." A Complaint and Request for Hearing of Cablevision of Boston Company, DPU/DTE 97-82 (1998), p. 40.

This same reasoning applies forcefully here. Adopting the Compact's method would establish a reasonable purchase price, and would facilitate negotiated agreements on the purchase price without costly and time-consuming adjudications. In contrast, the Company's method is a litigation breeder, and if adopted, it would frustrate the underlying objective of facilitating these purchases.

CONCLUSION

For all these reasons, the Department should rule as follows: 1) that the purchase price for street lights in Edgartown, Harwich, and Sandwich is $1.00; and 2) that the Compact's method for calculating the street light purchase price is correct, and the Company's method is incorrect.(5)

Respectfully Submitted

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1. The Compact's members include all twenty-one towns in Barnstable and Dukes County. Of those twenty-one towns, Falmouth and Yarmouth already own their street lights, and therefore do not join in this case.

2. The Company has apparently repudiated its earlier February 2000 Method, and does not seek the Department's approval of it.

3. The Legislature was well aware that the purchase price might be low, or even zero, for towns that are acquiring a stock of relatively old lights. See the testimony of the author of the provision, George Woodbury, in DTE 98-89 (Exhibit Compact 2, pps. 28-29).

4. Indeed, the Company's own witness, Mr. Aikman, conceded that amortization does not have the meaning that the Company has ascribed to it. Mr. Aikman stated that "amortization and depreciation mean two different things to me." Tr. 117. Amortization is an accounting concept for "the recovery of capital," while depreciation "signifies physical deterioration and obsolescence." Tr. 117, 116.

5. The Compact respectfully requests that this case be resolved as soon as possible, and notes that the sixty-day time line specified in G.L. c. 164, § 34A(d) expired on March 26, 2001.